FUTURE SUGAR POLICY NEEDS – A VIEW FROM THE TRADE

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I would like to thank John Love for asking me to speak, and thank all of you for your time and your attention. I have been asked to speak on futures sugar policy needs from the perspective of a member of the sugar trade. I should be clear that, while I spend my days working as an intermediary between sugar producers, processors, traders and industrial users and thus have what is hopefully a useful perspective, I am not, in fact, a "trader". As a sugar brokerage, my company does not take title to sugar and does not take positions in the market. We are not risk takers. Given this, I will nonetheless attempt to describe what a trader might like to see from future sugar legislation.

Participants in the sugar trade do not tend to have a natural stance in the market place. While a producer of sugar is a natural "long" and a manufacturer of refined sugar from raw sugar or a manufacturer of finished goods is a natural "short" in the market, a trader works between these various groups. It is natural component of a trader's profile that he be a risk taker.

By this I mean that a trader's role is, in part, to mitigate the market risk of producers, manufacturers and end users of sugar. The trader's role is that of merchant and market maker. The trader is often a taker of price cover in up markets and a giver of price cover in down markets as customers seek price cover. Price risk, country risk, counter-party risk (in both up and down markets, by the way), foreign currency and interest rate exposure, quality risk, and freight rate risk are a trader's lot in life by choice. I would argue, however, that the current sugar policy in the United States has dialed-up traders' risk in an unmanageable way and to an intolerable level, and that current sugar policy, if left unchanged, will continue to heighten traders' risk profile in the coming years.

You may ask yourself, why, should a trader's comfort level be of concern to other market participants? The trade is sometimes viewed as opportunistic or even mercenary in their dealings. I would argue that the operator plays a seminal role in the workings of the US market. Over 23 % of our supply of raw sugar for domestic consumption comes from the 40 quota-holding countries. The trade provides the means to finance and freight these sugars from origin to the US. Through long term pricing contracts with their customers in the US, the trade facilitates not only the supply of sugar, but also an efficient means of managing the market risk related to those transactions in increasingly illiquid markets. Anyone who has pondered taking a foreign producer to arbitration in a foreign jurisdiction over a defaulted contractual obligation understands at least one small component of the service provided to the broader market by the trade.

Each day all of us make risk/reward calculations. I would argue that the sugar trade's risk/reward ratio would argue against participating in the US market at all, and that current sugar policy has played a major role in skewing that ratio. One need only look at the volumes traded on the New York Board of Trade Sugar # 14 contract, or count the number of traders currently involved in the US sugar market on a day to day basis for evidence of the trades reluctance to participate.
What follows is a brief, and surely incomplete, listing of issues confronting the sugar trade, which discourage trade participation in the market.

Market access:
Quota - The current list of quota holders is badly outdated, based as it is on the period from 1975 to 1981. Many quota-holding nations are net-importers. Through the WTO, the US has guaranteed access to 40 countries based on their historical percentage. Many of these countries are not consistent shippers, while others are extremely efficient and could provide supply to the market in a far more reliable and efficient manner. One way to address this in efficiency would be the adoption of a first-come, first-served quota scheme, which would significantly enhance the trades' ability to deliver raw sugar to the market in a more efficient manner. The USDA could still manage this flow through the use of quarterly shipping patterns.

Mexico – Currently Mexico has a quota of 116,000 tonnes, yet the US Trade Representative's office has not given out the Certificates of Quota Eligibility that are needed to actually bring these sugars into the US market. With each week and month that passes, the logistical impediments of moving 116,000 tonnes of Mexican sugar to the US grow more daunting. As long as a broader comprehensive sweetener agreement between the US and Mexico is pending, the prospect of significantly increased Mexican access overhangs the market. How can anyone seeking to manage risk do so when we this important piece of the supply puzzle remains missing? It would be in the trade's interest to have this matter resolved, one way or the other.

Administrative issues:
The USDA publishes its **World Agricultural Supply and Demand Estimate** (WASDE) for sugar monthly, and this report represents, arguably, the most useful gauge of the market's prospects for a trader. In fact, the basis for the USDA's management of the Tariff Rate Quota is the ending stocks/use ratio as reported in the monthly WASDE. Due to the fact that the CCC is holding massive stocks, the ultimate disposition of which remains a mystery, ending stocks are not known within 793,000 tons. Based on the February report, actual accessible ending stocks are somewhere between 1.234 million tons and 2.027 million tons. The ending stocks to use ratio is somewhere between 19.4 % and 11.8 %. Taking steps immediately to clarify the disposition of these stocks would clarify the supply and demand picture, allowing for better decision making.

In the last year the market has been buffeted by a series of **market-distorting events**. For companies seeking to manage risk, these events add a further element of uncertainty. The following chronology of events serves to underscore this. I should point out that none of the following are necessarily good or bad; necessary or unnecessary; appropriate or inappropriate. They are simply actions taken by the USDA as part of its routine management of the sugar program, or actions taken in reaction to some shortcoming in the program or its management. Each of these had some impact on prices and thus on traders' risk profile.

September: Nothing happened. The TRQ announcement, normally made by September 15, is not made by September 30, 1999, leaving the market with no access to foreign supply as the new quota year begins. Various government agencies struggled over the recourse/non-recourse loan issue, precluding a timely announcement.

October: A waiver is granted, allowing California and Hawaiian Sugars to import 100,000 tons of sugar immediately and to export a like amount of sugar over a five-year period. The waiver is needed to prevent C&H form running out of sugar.

November 2: Quota is finally announced. Even now, 227,000 tonnes are left unallocated. While in the past, a clear program was detailed by which the quota would be allocated; the announcement stated simply that the USDA would make the sugars "available to the USTR, if needed, as the administration reviews market conditions and the operation of the sugar program".

December: It is announced that the time period for the export of sugars under the C&H waiver amended from five years to 180 days.

February: C&H waiver amended from 180 to 210 days. The announcement also states that the USDA will accept CQE's for retirement in lieu of exports by C&H.

May 11: USDA announces that it will purchase 150,000 tons of sugar and that additional purchases will be considered depending on market prices and conditions.

June 3: CCC actually purchases 132,000 tons of sugar from the industry.

July 25: Secretary Glickman addresses reporters, stating that he is considering authorizing another round of sugar purchases.

July 31: 44,940 tons refined sugar (raw value) forfeited.

August 21: FSA announces details of a Payment in Kind (PIK) program for sugar, the first of its kind for sugar.

August 31: 60,188 tons of refined sugar (raw value) and 50,281 tons of raw sugar raw value are forfeited.

September 19: USDA announces preliminary results of PIK program. More than 5,000 farmers offer to divert about 100,000 acres against 277,349 tons of refined sugar from CCC stocks. The title to these sugars will be transferred to assignees between October 1 and December 31, according to the announcement.

September 31, 2000: 534,277 tons of whites (raw value) and 269,307 tons of raws are forfeited to the CCC. CCC inventory jumps to 1.1 million tons raw value.

Lets look at this in sum. In rough numbers, the entire quota was delayed, 227,000 tonnes were left unallocated, the west coast waiver impacted 100,000 tonnes, 132,000 tons were purchased and 968,000 tons were forfeited. Thus, the flow of roughly 2.5 million tonnes of sugar – nearly 25 % of all sugar either domestically produced or imported last year - was affected (interrupted, impeded or precluded altogether) due to the program's faults or inadequacies. For traders attempting to judge a market with an eye on risk management, such constant intervention makes the process hopelessly complex.

What, from a trader's perspective, would be desirable in the context of futures policy needs? A look back at the intent of the current program will prove enlightening.

The program is currently set up to accommodate a minimal quota as per the WTO, and supplemental tranches, which can be allocated based on needs. If at prescribed moments in time the ending stocks/use ratio for the given fiscal year is at or less than 15.5 % after the additional sugars had been considered, the USDA would direct the US Trade Representative to allocate the tranche. While this approach, which clearly borders on micro-management of the TRQ, may be cumbersome there is at least a level of predictability to it. Traders would prefer no intervention at all, but scheduled or predictable intervention is the next best option.

This administrative approach, while theoretically still in place, is in reality no longer viable. The growth seen in the domestic crop, the partial opening of the US market to foreign supply through the NAFTA and the sharp increase in over-quota imports in the form of sugar containing products and syrups have taken control of the market away from the USDA. The regimented approach to managing the quota has been replaced by a series of either pre-emptive or reactionary moves.

At the excellent sessions earlier today, we heard the views of a beet grower, a processor and a marketing firm. While each of these industry segments has a vested interest in the shape of US domestic sugar policy, those in the trade ask only for a policy that is not inherently dysfunctional. All that the trade can ask is that sugar policy evolve and adapt to the current realities. By 2008, we will have an open border with Mexico, and it is likely that Mexican imports will profoundly impact our market years before then. If the US sugar policy and resultant program is so dated that it can only be run through crisis management, a trader would ask that the USDA take whatever actions are necessary to bring the market back under control.

The best of all worlds for the sugar trade would be a market completely free from intervention. While this is not realistic given that only a small percentage of world sugar trade is not either subsidized of protected in some way, a market that is well enough structured that it can be managed in a rational, thoughtful manner should not be too much to ask for.